

Hold the Phone (Charges)

...

The Legal and Policy Implications of Extending Legacy
Charges to IP Services



Summary

This White Paper explores the legal and policy implications of the Federal Communications Commission (FCC or Commission) extending carrier access charges to Voice over Internet Protocol (VoIP) and Internet Protocol (IP) services.*

The FCC is grappling with a sea change in our nation's communications infrastructure. Legacy telephone networks with limited functionality and technological inefficiencies are steadily being replaced with broadband architecture that is driven by Internet IP technology. Modern IP networks are far more efficient and flexible than legacy facilities. The IP-based services they deliver, including VoIP, empower users by offering innovative features, far different from "plain old telephone service." IP-everywhere is still not yet a reality, which is why the FCC has established the swift transformation to all-IP networks as a key national priority. This transition, however, is not guaranteed. Some parties are urging the FCC to regulate burgeoning IP services and treat them just like yesterday's phone services, including requiring VoIP services to pay telephone carrier charges. Expanding these rate regulations, designed over thirty years ago, to modern networks and services would violate the FCC's statutory mandates to promote broadband adoption and to avoid burdening innovative services with regulation and would harm consumer welfare.

* This White Paper was prepared by the following supporters of the Tech/Users Framework for intercarrier compensation and universal service reform: Google Inc., Skype Communications S.A.R.L., Sprint Nextel Corporation and Vonage Holdings Corp. See Tech/Users Letter to Julius Genachowski, Chairman, FCC, *et al.*, WC Dkt. 10-90, *et al.* (filed Aug. 18, 2011).

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Section 1. Background and Overview

History of FCC Action

In February 2011, the Federal Communications Commission (FCC or Commission) launched a proceeding to modernize the nation's intercarrier compensation regime (ICC) for telecommunications traffic exchange and the federal system supporting universal communications service (USF).¹ To deliver the benefits of broadband to all Americans as described in its seminal 2010 *National Broadband Plan*, the FCC proposed to shift the focus of ICC and USF from voice telephony to the goal of promoting ubiquitous broadband infrastructure and all-Internet Protocol (IP) networks throughout the country, with voice becoming just one of many services and applications.²

All stakeholders agree that reform of ICC and USF is needed. ICC charges, especially per-minute carrier access charges, are too high, even for legacy telephone networks. Current carrier access charges include implicit subsidies that may have been a rational transitional step in the 1980s when phone service was largely provided by AT&T,³ but such implicit subsidies mask costs, distort market activity and interfere with robust competition. This is why the Telecommunications Act of 1996 (1996 Act) directs the FCC to ensure that all subsidies that support universal communications service be explicit.⁴

The path to ICC and USF reform has proved difficult and previous attempts to alter these entrenched systems have been stymied. After the passage of the 1996 Act, the FCC embarked on ICC reform, examining many of the same issues it is currently grappling with, especially how to reduce the inflated carrier access charges that apply to TDM telephone traffic.⁵ The FCC made some modest progress in reducing inefficient, above-cost, interstate carrier access rates in 2000 and 2001, but it was

¹ See *In the Matter of Connect America Fund, et al., Notice of Proposed Rulemaking and Further Notice of Proposed Rulemaking*, 26 FCC Rcd. 4554 (2011) ("NPRM"); see also *Further Inquiry Into Certain Issues in the Universal Service-Intercarrier Compensation Transformation Proceeding*, *Public Notice*, DA 11-1348 (rel. Aug. 3, 2011) ("Public Notice").

² See Omnibus Broadband Initiative, *Connecting America: The National Broadband Plan* at 145, GN Dkt. 09-51 (rel. Mar. 16, 2010) ("*National Broadband Plan*"); see also NPRM at ¶ 10.

³ See NPRM at ¶¶ 46-48; see also *In the Matter of MTS and WATS Market Structure*, *Memorandum Opinion and Order*, 97 FCC 2d 682, ¶ 10 (1983) ("*MTS and WATS Market Structure Order*").

⁴ See 47 U.S.C. § 254(e) (2011).

⁵ See *In the Matter of Access Charge Reform, et al., First Report and Order*, 12 FCC Rcd. 15982, ¶ 344 (1997) ("*Access Charge Reform First Report and Order*").

not enough.⁶ Most recently, in 2008, the FCC tried to tackle these issues, but was unable to effectuate reform.⁷

The Differences Between IP and TDM Networks

In recent years, IP – a more flexible, efficient and dynamic network protocol – has rapidly begun to replace TDM technology in our nation’s communications networks. By 2015, the vast majority of fixed lines in North America are expected to be IP.⁸

Unlike TDM, which was premised on a centrally-controlled network and separate SS7 signaling, the modular, layered IP network model offers a fast, stable, and application-agnostic platform for smart devices and terminals to run countless services and applications. This network design permits carriers and others (including end users) to develop and deploy enhanced applications and services independent of manufacturers’ switches or other network constraints, creating a platform for innovative and improved services.⁹ In addition to providing voice, IP networks, for example, can support broadband Internet access, IP video, enterprise unified communications services, and cloud-based applications.¹⁰ IP networks also feature improved reliability and survivability compared with TDM-based networks.¹¹

The economics of IP differ markedly from those of TDM. IP is more cost efficient. The cost of IP call carriage is not distance-sensitive in the same manner as TDM traffic.¹² IP networks also are not designed around jurisdictional boundaries, operating instead on an end-to-end, modular, interconnected basis across the country (and the world). Further, while TDM traffic, such as a voice telephone call,

⁶ See *In the Matter of Access Charge Reform, et al.*, Sixth Report and Order, Report and Order, Eleventh Report and Order, 15 FCC Rcd. 12962, ¶203 (2000) (subsequent history omitted); *In the Matter of Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers, et al.*, Second Report and Order and Further Notice of Proposed Rulemaking, 16 FCC Rcd. 19613, ¶ 54 (2001).

⁷ *In the Matter of High-Cost Universal Service Support, et al.*, Order on Remand and Report and Order and Further Notice of Proposed Rulemaking, 24 FCC Rcd. 6475, ¶ 261 (2008) (“2008 Order and ICC/USF FNPRM”).

⁸ See, e.g., Jim Hodges, *Network Modernization in the Era of All-IP Networks* at 9, Heavy Reading, White Paper (May 2011) (“Network Modernization”).

⁹ See NPRM at ¶ 506.

¹⁰ See, e.g., Press Release, NeoNova, Rural ISPs Flock to Google Apps for New Services (Aug. 10, 2011), <http://www.neonova.net/sites/default/files/CustomersFlocktoGoogle.pdf>.

¹¹ See, e.g., *Network Modernization* at 5-7; Redacted Letter from Russell M. Blau, Counsel, Neutral Tandem, Inc., to Marlene H. Dortch, Secretary, FCC, at 1-2, CC Dkt. 01-92, GN Dkt. 09-51 (filed Oct. 22, 2010).

¹² *National Broadband Plan* at 142.

occupies a single physical channel, IP enables delivery of multiple communications services simultaneously on a single line. The incremental cost of terminating a voice call is already near zero on TDM networks and is falling with IP technology.¹³

These differences between TDM and IP networks suffuse the many ongoing policy challenges confronting the FCC. Regulatory models, engineering and economic assumptions developed in the era of centralized TDM phone networks simply do not fit IP network architecture.

Challenges to Meeting FCC Goals

Now, even though there is general consensus that carrier access charges remain too high, some parties are urging the FCC to export these outdated rate regulations to IP networks and services.¹⁴ They ask the FCC to expand access charge regulation to Voice over Internet Protocol (VoIP), despite the fact that these charges are irrational even for TDM traffic, fundamentally incompatible with IP networks, and run counter to the goals delineated by the FCC.¹⁵

The need for reform is more urgent than ever because the stakes are so high. Ubiquitous broadband infrastructure and all-IP networks will enhance our national competitiveness and productivity. The FCC can meet its reform goals swiftly, but must resist calls to perpetuate a rate regime designed for another era. To create incentives for network modernization, the FCC should embrace a future-focused paradigm grounded in technological and market efficiencies and opportunities.

¹³ See, e.g., Comments of Google Inc. at 16-17, WC Dkt. 10-90, *et al.* (filed Aug. 24, 2011) ("Google August 24 Comments").

¹⁴ See, e.g., Letter from AT&T, CenturyLink, Fairpoint Communications, Frontier, Verizon and Windstream, to Julius Genachowski, Chairman, FCC, *et al.*, WC Dkt. 10-90, *et al.* (filed July 29, 2011) ("*ABC Plan*"), Framework of the Proposal, Attach. 1 at 10.

¹⁵ *Id.*

Section 2. Extending Access Charges to VoIP Services Would Violate the FCC's Mandate to Keep Information Services Unregulated

The Communications Act, as amended by the 1996 Act, (Act) requires the FCC to approach its regulatory actions pursuant to a specific framework. Under the statutory framework, services using telecommunications are either “telecommunications services,”¹⁶ which include services the FCC regulates, or “information services,”¹⁷ which have been subject to an affirmative policy of non-regulation. While several services can be offered together in one bundle to a user, the reason for these mutually-exclusive service classifications was to ensure that the FCC did not subject information services to burdensome regulation.¹⁸ In assessing how to adjust its regulation to promote IP network deployment, including how to account for the emergence of VoIP, the FCC must recognize this statutory framework.

The Breadth of VoIP Services Precludes a Simplistic Approach to Classification

The term VoIP describes a certain class of service offerings provided over communications networks using IP as the transmission protocol. Yet, VoIP and other IP-based voice services and applications, represent a vast array of offerings with various features and functionalities. Simply utilizing IP as the transmission protocol or including a voice component in a service offering does not automatically dictate the regulatory classification of a service. The FCC cannot assume that all VoIP services are the same or that all VoIP fits either the “telecommunications services” or “information services” classification.¹⁹ Regardless of whether the FCC

¹⁶ The term “telecommunications service” means “the offering of telecommunications for a fee directly to the public, or to such classes of users as to be effectively available directly to the public, regardless of the facilities used.” 47 U.S.C. § 153(53) (2011).

¹⁷ The term “information service” means “the offering of a capability for generating, acquiring, storing, transforming, processing, retrieving, utilizing, or making available information via telecommunications, and includes electronic publishing, but does not include any use of any such capability for the management, control, or operation of a telecommunications system or the management of a telecommunications service.” 47 U.S.C. § 153(24) (2011).

¹⁸ See *In the Matter of Federal-State Board on Universal Service, Report to Congress*, 12 FCC Rcd. 8776, ¶ 45 (1997); *In the Matter of Petition for Declaratory Ruling that pulver.com's Free World Dialup is Neither Telecommunications Nor a Telecommunications Service, Memorandum Opinion and Order*, 19 FCC Rcd. 3307, ¶ 19 (2004) (“Free World Dialup”).

¹⁹ See *In the Matter of AT&T's Phone-to-Phone IP Telephony Services, Order*, 19 FCC Rcd. 7457, ¶ 24 (2004) (holding that one form of VoIP is a “telecommunications service”). The Commission has also held that other IP-based voice services are “information services.” See *Free World Dialup* at ¶ 19.

classifies a VoIP service as a telecommunications service, it does not automatically follow that legacy access charges can, or should, be applied.

As the FCC has recognized in various contexts, IP-based voice services and applications encompass a diverse group of products, encompassing fixed and nomadic services,²⁰ facilities-based services,²¹ and interconnected VoIP services²² offered for a fee that provide voice telephony and do not require users to purchase a separate broadband access service (such as offered by many facilities-based providers).²³ The term VoIP also includes feature rich and “over-the-top” voice services accessible from any Internet connection that are often offered free (or at very low prices) to users,²⁴ as well as software platforms that include a voice component to a greater or lesser degree as part of an integrated package of features. This wide array of VoIP offerings defies a simple regulatory categorization or traditional regulatory treatment.

Many, if not most, IP-based voice services are properly classified as “information services” as defined under the Act, providing consumers “value-added” enhancements.²⁵ The relevant statutory distinction is whether the end user is empowered to interact with stored information and to use voice capabilities in ways fundamentally different than traditional “plain old telephone service.” Numerous VoIP services, for example, enable users to establish and interact with pre-defined criteria regarding how calls should be delivered, including priority treatment, forwarding, and device delivery options. Many VoIP services typically also engage in a “net protocol conversion” between IP and TDM formats, which the Commission has held previously to be an information service.²⁶ This is why the FCC previously

²⁰ See, e.g., *In the Matter of Preserving the Open Internet*, Report and Order, 25 FCC Rcd. 17905, ¶ 22 (2010) (noting differences between fixed and nomadic services).

²¹ See, e.g., *SBC Communications Inc. and AT&T Corp. Applications for Approval of Transfer of Control*, Memorandum Opinion and Order, 20 FCC Rcd. 18290, ¶¶ 86-87 (2005).

²² 47 C.F.R. § 9.3 (2011).

²³ See, e.g., *ABC Plan*, Legal Authority Whitepaper, Attach. 5 at 22 (“*ABC Plan Legal Authority Whitepaper*”).

²⁴ *The Proposed Extension of Part 4 of the Commission's Rules Regarding Outage Reporting to Interconnected Voice Over Internet Protocol Service Providers and Broadband Internet Service Providers*, Notice of Proposed Rulemaking, 26 FCC Rcd. 7166, ¶ 25, n.66 (2011).

²⁵ See, e.g., Comments of Sprint Nextel Corp. at 3-4, WC Dkt. 10-90, *et al.* (filed Mar. 1, 2011); Comments of Sprint Nextel Corp. at 17-20, WC Dkt. 10-90, *et al.* (filed Aug. 24, 2011) (“Sprint August 24 Comments”); Comments of Verizon and Verizon Wireless at 31-33, WC Dkt. 10-90, *et al.* (filed Mar. 1, 2011). See also Opposition of AT&T, Inc. at 3-8, WC Dkt. 11-119 (filed Aug. 15, 2011).

²⁶ *In the Matter of Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act*, First Report and Order, 11 FCC Rcd. 21905, ¶¶ 104-105 (1996), as modified by, Order on Reconsideration, 12 FCC Rcd. 2297 (1997) (“*Non-Accounting Safeguards Order*”).

has recognized that IP-based voice services integrated with advanced features that provide information about other users, presence information, and a variety of communications features and options are “information services” under the Act.²⁷

In fact, many types of Internet offerings, including apps stores, online instant messaging platforms, and online games, may include some human voice element but do not include the underlying telecommunications transmission component required to be deemed an “information service” by the Act.²⁸ Instead, these offerings are online software-based platforms and applications that fall outside the scope of the FCC’s jurisdiction.²⁹

It is also unclear what services would be encompassed by “‘one-way’ interconnected VoIP,” which some parties propose to impose carrier access charges upon.³⁰ The FCC’s definition of “interconnected VoIP” clearly encompasses only a two-way service so that “one-way interconnected VoIP” makes little sense.³¹ In any case, most, if not all, “one-way” VoIP services are likely to be information services and may even be software applications or online offerings wholly outside of the Commission’s jurisdiction. Applying traditional telecommunications regulations to these services would stymie investment and innovation in such services, directly contrary to the FCC’s obligations.

The FCC also has not undertaken the pre-requisites under the Administrative Procedure Act (APA) necessary to impose rate regulation on “one-way” VoIP.³² The term “one-way interconnected VoIP” is not defined by the Act or in the Commission’s rules. Neither has the FCC provided a proposed definition of the term, or provided notice, explanation or justification of the proposed regulation.

²⁷ *Free World Dialup* at ¶¶ 11-12.

²⁸ See, e.g., *National Cable & Telecommunications Assn. v. Brand X Internet Services*, 545 U.S. 967, 976-77 (2005).

²⁹ See, e.g., *Am. Library Ass’n v. FCC*, 406 F.3d 689, 691-692 (D.C. Cir. 2005).

³⁰ See Public Notice at 17, n.57.

³¹ See 47 C.F.R. § 9.3 (2011).

³² To adopt a new definition by rule, the APA requires the FCC to engage in notice-and-comment rulemaking and to examine the regulatory implications of the rule. Notice must be “sufficient to fairly apprise interested parties of all significant subjects and issues involved.” *American Iron & Steel Institute v. Environmental Protection Agency*, 568 F.2d 284, 291 (3d Cir. 1977) (internal quotations omitted).

Congress Has Established a National Policy to Encourage the Growth and Development of Interactive and Internet Services

Congress has also made clear why the FCC cannot extend telephone carrier rate regulation to VoIP services. Section 230 states it is expressly “the policy of the United States” to “promote the continued development of the Internet and other interactive computer services” and to “preserve the vibrant and competitive free market that presently exists for the Internet and other interactive computer services, unfettered by Federal or State regulation.”³³ Imposing carrier access charges on VoIP services would run directly contrary to the statutory framework and Congressional intent.³⁴ However well the intricate access charge regime may have suited circuit-switched analog telephony, it would be contrary to the policies of Section 230 for the FCC to impose rate regulation upon evolving Internet applications and cutting edge VoIP services.

The FCC Consistently Has Found That a Light Regulatory Touch Best Promotes Innovation and Investment

Decades of Commission precedent confirms that sound public policy favors a light regulatory touch to promote competition, innovation and investment. Consistent with the goal of promoting “information services,” the FCC’s Part 69 rules have been crafted carefully to avoid the expansion of access charges to end users.³⁵ These longstanding FCC rules are narrowly limited to apply only to a “telecommunication” originated or terminated by “telephone companies.”³⁶ The rules also make clear that end users expressly are not carriers and are not subject to carrier access charges.³⁷

In a 1983 order addressing how access charges should apply to enhanced service providers (ESPs), now termed information service providers (ISPs), the FCC stressed that ESPs should not be subject to interstate carrier’s carrier access charges.³⁸ The FCC deemed ESPs to be “end users” under the Commission’s rules.³⁹

³³ 47 U.S.C. § 230(b)(2) (2011).

³⁴ See *Non-Accounting Safeguards Order* at ¶ 102.

³⁵ See, e.g., 47 C.F.R. §§ 69.5(a), (b) (2011).

³⁶ See, e.g., *id.* §§ 69.1, 69.2(b).

³⁷ See *id.* § 69.2(m).

³⁸ *MTS and WATS Market Structure Order* at ¶ 83.

³⁹ See *In the Matter of Northwest Bell Telephone Company Petition for Declaratory Ruling*, Memorandum Opinion and Order, 2 FCC Rcd. 5986, ¶ 20 (1987).

The FCC reiterated this conclusion in 1988, reaffirming that ESPs, as end users, cannot be required to pay carrier charges.⁴⁰

After passage of the 1996 Act, the FCC again refused to extend access charges to end users and ISPs. The FCC concluded that “had access rates applied to ISPs over the last 14 years, the pace of development of the Internet and other services may not have been so rapid.”⁴¹ The Commission emphasized that its decision to refrain from expanding access charges furthered the goals of the 1996 Act “to ‘preserve the vibrant and competitive free market that presently exists for the Internet and other interactive computer services, unfettered by Federal or State regulation.’”⁴² The same is just as true today.

No party has presented any facts or cited any changed circumstances that would justify the Commission’s reversal of this well-settled precedent.⁴³ Rather, the policies and statutory underpinnings that led the FCC to refrain from extending legacy access charges are as strong as ever when viewed in the context of still-evolving IP services arena.⁴⁴

⁴⁰ *In the Matter of Amendments of Part 69 of the Commission’s Rules Relating to Enhanced Service Providers*, Order, 3 FCC Rcd. 2631, ¶ 2, n.8 (1988).

⁴¹ *Access Charge Reform First Report and Order* at ¶ 344.

⁴² *Id.* (citing 47 U.S.C. § 230(b)(2)).

⁴³ Under the APA, agency actions may be set aside as “arbitrary and capricious” if they depart from established precedent without a well-reasoned justification. *See Ramaprakash v. FAA*, 346 F.3d 1121, 1124-1125 (D.C. Cir. 2003) (citing *Greater Boston Television Corp. v. FCC*, 444 F.2d 841, 852 (D.C. Cir. 1970)).

⁴⁴ *See* Google August 24 Comments at 17 (given the record of very low costs of termination of IP traffic, imposing higher rates would “would undermine the goals of Section 706 of the Telecommunications Act and the FCC’s objectives by hindering IP advanced services deployment.”); Letter of Ad Hoc Telecommunications Users, Google Inc., Skype Communications S.A.R.L., Sprint Nextel Corporation, and Vonage Holdings Corp., to Julius Genachowski, Chairman, FCC, *et al.*, at 9, WC Dkt. No. 10-90, *et al.* (filed Aug. 18, 2011) (“Tech/Users Letter”) (“Moreover, imposing such an arbitrary rate would have a devastating effect on IP advanced services deployment, contrary to the goals of Section 706 and the stated objectives of this proceeding.”).

Section 3. Expanding Carrier Access Charges Conflicts with FCC Obligations to Promote Advanced Telecommunications Capability and Exceeds FCC Authority

The FCC is under a statutory obligation to encourage advanced telecommunications capability, including the acceleration of broadband deployment. Extending access charges to VoIP will have exactly the opposite effect, dampening demand for and deployment of broadband services. The statute also precludes the FCC from expanding the access charge regime beyond services grandfathered under the 1996 Act.

The FCC is Required to Encourage the Deployment of Advanced Telecommunications Capability

Section 706 of the 1996 Act provides a direct mandate to the FCC and an affirmative grant of authority to ensure that the delineated goals are attained. Section 706 reflects Congressional intent that the FCC encourage the deployment of advanced telecommunications capability to all Americans.⁴⁵ Imposing access charges on VoIP, however, will discourage the deployment of advanced capabilities and adversely impact national broadband goals.⁴⁶

The FCC repeatedly has concluded that VoIP service adoption leads to broadband deployment and investment and supports the goals of Section 706.⁴⁷ The FCC has

⁴⁵ See 47 U.S.C. §§ 1302(a), (b) (2011). Section 706(a) instructs the FCC to “encourage the deployment on a reasonable and timely basis of advanced telecommunications capability to all Americans” and delineates “regulating methods” the FCC may utilize to attain that goal. *Id.* § 1302(a). Section 706(b) further requires the FCC to assess whether “advanced telecommunications capability is being deployed to all Americans in a reasonable and timely fashion,” and, if it is not, directs the FCC to “take immediate action to accelerate deployment of such capability by removing barriers to infrastructure investment and by promoting competition in the telecommunications market.” *Id.* § 1302(b). Under the Act, both interconnected and non-interconnected VoIP services are defined as “advanced communications services.” *Id.* §§ 153(1)(A), (B). The term “advanced communications services” was added to the Act by the Twenty-First Century Communications and Video Accessibility Act of 2010, Pub. L. No. 111-264, 125 Stat. 275 (2010) (codified at 47 U.S.C. §§ 153, 225, 303, 330, 410, 613, 615c, 616-70). While there are slight variations between advanced telecommunications capability and advanced communications services, Congress clearly intended both terms to encompass services with advanced features, such as VoIP and IP-enabled services.

⁴⁶ *National Broadband Plan* at 142.

⁴⁷ See, e.g., *In the Matter of Implementation of the Telecommunications Act of 1996: Telecommunications Carriers’ Use of Customer Proprietary Network Information and Other Customer Information; IP-Enabled Services*, Report and Order and Further Notice of Proposed Rulemaking, 22 FCC Rcd. 6927, ¶ 59 (2007); *In the Matter of Time Warner Cable Request for Declaratory Ruling that Competitive Local Exchange Carriers May Obtain Interconnection Under Section 251 of the Communications Act of 1934, as Amended, to Provide Wholesale Telecommunications Services to VoIP Providers*, Memorandum Opinion and Order, 22 FCC Rcd. 3513, ¶ 13 (continued on following page)

stressed that broadband deployment depends directly on the introduction and proliferation of popular applications such as VoIP: “[N]ew applications draw interest among end-users, bring new users online and increase use among those who already subscribe to broadband services.”⁴⁸

The FCC has found specifically that advanced telecommunications capability is not being deployed to all Americans in a reasonable and timely manner.⁴⁹ Consequently, the Commission is required by Section 706(b) to accelerate deployment.⁵⁰ Creation of new VoIP charges, however, will raise costs and user prices, stifling demand for broadband and creating disincentives to invest in new IP-enabled voice applications. The evidence shows that subjecting VoIP to access charges could easily cost about \$1 billion per year, which would mean higher prices for consumers and the inability of providers to use those funds for more productive purposes, including investment in network upgrades and service quality improvements.⁵¹

As recently reiterated by 34 Members of Congress,⁵² the FCC’s reform should not ignore the broadband adoption gap identified in the *National Broadband Plan*. VoIP drives broadband adoption by enhancing the value proposition for broadband consumers. VoIP products and services can also maximize consumers’ spending on communications services, but only to the extent that VoIP providers are not required to offer their services at price points that continue to subsidize legacy technology. Particularly in the realm of Internet-based services, which are often offered to end users for free or at extremely low prices, even small input cost increases may render innovative new services non-viable. Simply put, the

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(2007); *In the Matters of IP-Enabled Services; E911 Requirements for IP-Enabled Service Providers, First Report and Order and Notice of Proposed Rulemaking*, 20 FCC Rcd. 10245, ¶ 31 (2005); *Free World Dialup* at ¶ 19.

⁴⁸ *National Broadband Plan* at 15. See also Letter of Richard S. Whitt, Google Inc., to Marlene H. Dortch, Secretary, FCC, at 5, CC Dkt. 01-92, *et al.* (filed Feb. 1, 2011); Comments of the Voice On the Net Coalition at 8, WC Dkt. 10-90, *et al.* (filed Aug. 24, 2011) (“VON Coalition August 24 Comments”).

⁴⁹ See *In the Matter of Inquiry Concerning the Deployment of Advanced Telecommunications Capability to All Americans in a Reasonable and Timely Fashion, Seventh Broadband Progress Report and Order on Reconsideration*, 26 FCC Rcd. 8008, ¶ 1 (2011); *In the Matter of Inquiry Concerning the Deployment of Advanced Telecommunications Capability to All Americans in a Reasonable and Timely Fashion, Sixth Broadband Progress Report*, 25 FCC Rcd. 9556, ¶ 2 (2010).

⁵⁰ See 47 U.S.C. § 1302(b) (2011).

⁵¹ See Sprint August 24 Comments at 19.

⁵² See Letter from Rep. Doris Matsui (D-Ca.), *et al.* to Julius Genachowski, Chairman, FCC (filed Sept. 27, 2011).

imposition of access charges on VoIP would “hinder[] the transformation of America’s networks to broadband.”⁵³

Expanding the Interim Carrier Access Charge Regime Exceeds the FCC’s Authority under Section 251(g)

Legal precedent underscores that the FCC’s primary source of authority for regulating access charges, Section 251(g) of the Act, prohibits the FCC from expanding the access charge regime to VoIP services. Section 251(g) was adopted to clarify that the access charge regime for long distance telephone calls in place at the time of the passage of the 1996 Act was grandfathered.⁵⁴ As the D.C. Circuit has explained, Section 251(g) is “a transitional device” designed to preserve the system of carrier access charges in place at the time of the enactment of the 1996 Act until such time as the Commission adopted new rules.⁵⁵

The FCC knows well the limitations of this statutory authority. In 2002, the courts rejected an attempt by the FCC to rely on Section 251(g) in connection with dial-up traffic bound for Internet service providers. It is now clear that Section 251(g) can “not be relied on for authority to promulgate new regulations.”⁵⁶ Neither the FCC nor any other party suggested that access charges applied to VoIP services at the time of the 1996 Act was enacted.⁵⁷

Neither does the FCC’s limited discretion to adopt reasonable transitions from one rate regulation system to another, including interim rate levels, permit the FCC to impose carrier charges on VoIP.⁵⁸ In fact, the authority to adopt transitional or interim rate rules is permitted only where it is designed to avoid “marketplace disruption” or “rate shock.”⁵⁹ By contrast, applying access charges to VoIP services would itself lead to significant market disruption and user rate shock.⁶⁰ Further,

⁵³ *National Broadband Plan* at 142.

⁵⁴ See *ABC Plan Legal Authority Whitepaper* at 11-12.

⁵⁵ *WorldCom, Inc. v. FCC*, 288 F.3d 429, 430 (D.C. Cir. 2002) (“*WorldCom*”).

⁵⁶ *Core Communs., Inc. v. FCC*, 592 F.3d 139, 142 (D.C. Cir. 2010) (describing the court’s holding in *WorldCom*).

⁵⁷ *AT&T Corp. v. YMax Communs. Corp.*, Memorandum Opinion and Order, 26 FCC Rcd. 5742, ¶1, n.7 (2011) (“‘The Commission has never addressed whether interconnected VoIP is subject to intercarrier compensation rules and, if so, the applicable rate for such traffic,’ and is ‘seek[ing] comment on the appropriate intercarrier compensation framework for [VoIP] traffic’ in a pending proceeding.”) (internal citations omitted).

⁵⁸ Cf. *ABC Plan Legal Authority Whitepaper* at 38-39.

⁵⁹ *Competitive Telecomms. Ass’n v. FCC*, 309 F.3d 8, 14 (D.C. Cir. 2002) (upholding FCC rules because “[a]voidance of market disruption pending broader reforms is, of course, a standard and accepted justification for a temporary rule.”). See VON Coalition August 24 Comments at 19.

⁶⁰ See Sprint August 24 Comments at 19.

there is nothing “interim” about the proposal of permanent access charges on VoIP, whether at the initial interstate rate or at a lower, unified end-state rate.

Section 4. Imposing Carrier Access Charges on VoIP Would be Unreasonable and Arbitrary

Even if the Commission determines to classify certain VoIP services as telecommunications services, the Act still requires that rates be reasonable. The facts show that a bill-and-keep regime best fits all traffic exchange including IP traffic.

Inflated Carrier Access Charges are not Just and Reasonable

The Commission has authority to regulate rates for interstate telecommunications services.⁶¹ This authority, however, is derived from and constrained by Section 201 of the Act, which requires that rates for telecommunications services be “just and reasonable.”⁶² It is well settled that “[a] basic principle used to ensure that rates are ‘just and reasonable’ [pursuant to Section 201(b)] is that rates are determined on the basis of cost.”⁶³ As such, if the FCC concludes that some VoIP offerings are telecommunications services and creates a new rate regime for VoIP telecommunications service traffic under the authority of Section 201(b), the “just and reasonable” mandate necessitates that rates be rationally-related to costs. This is true whether on a transitional or permanent basis. Subjecting VoIP telecommunications services to current interstate access charges for several years, and thereafter reducing the access charge rates to a permanent \$0.0007 per-minute rate, is decidedly not reasonable.

The FCC has stressed that current carrier access charges are above-cost, even for TDM traffic.⁶⁴ According to the *National Broadband Plan*, “ICC has not been reformed to reflect fundamental, ongoing shifts in technology and consumer

⁶¹ See 47 U.S.C. § 201 (2011). The FCC has noted the inherently interstate nature of IP traffic. *In the Matter of Vonage Holdings Corporation Petition for Declaratory Ruling Concerning an Order of the Minnesota Public Utilities Commission, Memorandum Opinion and Order*, 19 FCC Rcd. 22404, ¶¶ 1, 14 (2004), *aff’d sub nom.*, *Minn. Pub. Utils. Comm’n v. FCC*, 483 F.3d 570 (8th Cir. 2007).

⁶² See 47 U.S.C. § 201(b) (2011). See also *Core Communs.*, F.3d at 144.

⁶³ *ALLTEL Corp. v. FCC*, 838 F.2d 551, 557 (D.C. Cir. 1988) (citing *MCI Telecomms. Corp. v. FCC*, 675 F.2d 408, 410 (D.C. Cir. 1982)). See also *MTS and WATS Market Structure Order* at ¶ 10 (“Preeminent among these principles [of FCC ratemaking] is the conclusion that ‘actual costs of providing service underlie the statutory requirement that rates be just, reasonable and nondiscriminatory.’”).

⁶⁴ NPRM at ¶ 34.

behavior, and it continues to include above-cost rates.”⁶⁵ Even fifteen years ago, the Commission acknowledged that “the existing access charge system includes non-cost-based rates and inefficient rate structures.”⁶⁶ Since IP costs are unquestionably lower than TDM costs and the legacy per-minute access rates are well above TDM costs, the continued imposition of access rates is unreasonable for *any* traffic, and thus it would be clearly unreasonable to extend the application of those inflated rates to IP traffic.⁶⁷ In addition to violating the requirement that rates be just and reasonable, extending legacy per-minute access charges to VoIP is fundamentally unsound as a matter of public policy. The public interest is served where any traffic exchange rates reflect the cost of efficient, modern networks, *i.e.*, IP networks. Legacy per-minute access rates bear no resemblance to IP-network costs.

Available evidence demonstrates this fact. For example, data has shown that the cost of an IP voice call is between \$0.000012 and \$0.000084 per-minute.⁶⁸ Sprint has demonstrated that if carrier access charges were to apply to VoIP, “*even the ‘lowest’ access rate constitutes 100 percent profit to the LEC.*”⁶⁹ In 2008, the FCC itself used a conservative usage and pricing model to estimate that the incremental cost of delivering voice service over an IP network was roughly \$0.0000001 per-minute.⁷⁰ In making this assessment, the FCC stated “it is clear that the cost of voice traffic on a broadband network is vanishingly small. . . . [A]s carriers move to an all IP broadband world, the incremental costs of terminating voice calls should drop dramatically.”⁷¹ The FCC recognized that IP technologies make possible dramatic reductions in the cost of originating and terminating voice traffic in the network.⁷²

⁶⁵ *National Broadband Plan* at 142.

⁶⁶ *In the Matter of Access Charge Reform, Notice of Proposed Rulemaking, Third Report and Order, and Notice of Inquiry*, 11 FCC Rcd. 21354, ¶ 288 (1996).

⁶⁷ See, e.g., NPRM at ¶ 527; Comments of Google at 7, WC Dkt. 10-90, *et al.* (filed Apr. 1, 2011); Comments of Google at 6-9, WC Dkt. 10-90, *et al.* (filed Apr. 18, 2011); Google August 24 Comments at 7, 16; Sprint August 24 Comments at 9; Comments of Vonage Holdings Corp. at 3-5, WC Dkt. 10-90, *et al.* (filed Aug. 24, 2011); VON Coalition August 24 Comments at 3; Comments of XO Communications, LLC at 9, WC Dkt. 10-90, *et al.* (filed Aug. 24, 2011).

⁶⁸ See Google August 24 Comments at 16; Tech/Users Letter at 8. See also Letter from Devendra T. Kumar, Counsel to Netflix, to Marlene H. Dortch, Secretary, FCC, GN Dkt. 09-191, WC Dkt. 07-52 (filed May 10, 2011) (citing Lemay-Yates Associates Study, *The Cost of Incremental Internet Transit Bandwidth in the Local Cloud*, 29-30, Mar. 28, 2011).

⁶⁹ Letter of Charles McKee, Sprint Nextel Corp., to Marlene Dortch, Secretary, FCC, at 2, WC Dkt. 10-90, *et al.* (filed July 29, 2011) (emphasis in original).

⁷⁰ See 2008 Order and ICC/USF FNPRM at ¶ 261.

⁷¹ *Id.* at ¶¶ 260-61.

⁷² *Id.*

Given that almost four years have passed and IP costs have continued to fall, the FCC's 2008 estimate is likely too high and not "just and reasonable."

A Bill-and-Keep Methodology for VoIP would be Just and Reasonable

Since the incremental cost of terminating traffic is already virtually zero, a bill-and-keep methodology, where carriers recover their termination costs from their own end users, is most reasonable. The substantial administrative costs of tracking and billing for VoIP telecommunications service traffic could easily outweigh any network costs that application of the access charge regime could theoretically compensate.

Bill-and-keep is also consistent with the pricing methodology established in Section 252 for reciprocal compensation arrangements.⁷³ Section 252(d)(2) requires that such charges be based on a reasonable approximation of incremental costs,⁷⁴ and clearly contemplates the use of bill-and-keep.⁷⁵

⁷³ 47 U.S.C. § 252(d) (2011). Section 252(d) in conjunction with Section 201(b) permits the FCC to design a pricing methodology for all Section 251(b)(5) traffic. *See AT&T Corp. v. Iowa Utils. Bd.*, 525 U.S. 366, 378 (1999).

⁷⁴ 47 U.S.C. § 252(d)(2) (2011).

⁷⁵ *Id.* § 252(d)(2)(B)(i). *See also WorldCom*, 288 F.3d at 434 (noting "there is plainly a non-trivial likelihood that the Commission has authority to elect" a bill-and-keep system. . . .").

Section 5. Extending Carrier Access Charges to VoIP Will Markedly Reduce Consumer Welfare

Expanding rate regulation to VoIP is also inconsistent with sound public policy. Imposing new charges on VoIP will reduce consumer welfare. Economist Jerry Hausman has detailed the positive effects on consumer welfare, innovation, investment, and economic efficiency of aligning “rates more closely with costs by setting intercarrier compensation rates to near zero.”⁷⁶ Relying upon established economic principles, and extrapolating from the wireless context, Professor Hausman demonstrated that VoIP prices will fall and usage will increase if intercarrier compensation costs are “kept low or reduced.”⁷⁷

Today, access charges do not apply to VoIP services. Applying new charges to VoIP – essentially a sudden escalation of VoIP cost inputs – will therefore decrease consumer welfare, especially since the cost increases are not offset by any consumer gains. Unlike the wireless context where cost inputs were in fact reduced, spurring consumer welfare benefits, extending carrier access charges to VoIP would drive up consumer pricing, quashing usage and demand for the next generation of innovative IP-based services:

“VoIP providers, which must also recover their costs, would be forced to pass through these rate increases to their end users, which one estimate suggests would be about \$180 per year. Rates for innovative IP-enabled voice applications would increase, and innovation in and development of new IP enabled voice applications would be curtailed.”⁷⁸

If access charges are imposed on VoIP, consumers will be harmed by the increased costs of VoIP services, impaired innovation, decreased investment and fewer deployments of new services. These factors will, in turn, reduce adoption of broadband services.

⁷⁶ *ABC Plan*, Professor Hausman Consumer Benefits Paper, Attach. 4 at 8, 15.

⁷⁷ *Id.*

⁷⁸ VON Coalition August 24 Comments at 19.

Conclusion

Consistent with its statutory directives, the FCC should not saddle new IP networks and services with decades-old regulations applicable to outmoded services. To fulfill the obligations of the Communications Act, the FCC should leave innovative VoIP and other IP services unfettered by heavy-handed regulation. This approach will swiftly achieve the FCC's goals of universal access to broadband and rapid transformation to all-IP networks.